

# **Police and Fire Retirement System of the City of Detroit**

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**Financial Report  
with Supplemental Information  
June 30, 2013**

# **Police and Fire Retirement System of the City of Detroit**

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## Independent Auditor's Report

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Police and Fire Retirement System of the City of Detroit (the "System") as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

**Opinion**

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the net position of the Police and Fire Retirement System of the City of Detroit as of June 30, 2013 and the changes in its net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As described in Note 1 to the financial statements, the City of Detroit has filed for bankruptcy, calling into question the collectibility of the approximately \$71,000,000 of contributions receivable due from the City to the System. As a result of the considerable unknown related to the receipt of these receivables, as of June 30, 2013, these amounts have not been recorded within these financial statements. Approximately \$29,000,000 of that amount relates to contributions due from the prior year ended June 30, 2012, which was previously recognized as revenue by the System. Our opinion is not modified with respect to this matter.

As explained in Note 1, the financial statements include investments valued at approximately \$722,000,000 (24 percent of net position) at June 30, 2013 and at approximately \$750,000,000 (25 percent of net position) at June 30, 2012, whose fair values have been estimated by management in the absence of readily determinable market values. Management's estimates are based on information provided by investment managers, general partners, real estate advisors, and other means. Our opinion has not been modified with respect to this matter.

**Other Matters**

*Required Supplemental Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the pension system schedules of funding progress and employer contributions be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

*Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Police and Fire Retirement System of the City of Detroit's basic financial statements. The other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements.

The other supplemental information, as identified in the table of contents, is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplemental information, as identified in the table of contents, is fairly stated in all material respects in relation to the basic financial statements as a whole.

*Plante & Morse, PLLC*

December 19, 2013

# Police and Fire Retirement System of the City of Detroit

## Management's Discussion and Analysis

### Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required and other supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The financial statements are followed by sections of required and other supplemental information that further explain and support the information in the financial statements.

### Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the two prior years:

	Fiscal Year Ended		
	June 30, 2013	June 30, 2012	June 30, 2011
Total assets	\$ 3,386,191,753	\$ 3,328,847,402	\$ 3,717,411,629
Total liabilities	351,618,689	354,385,769	337,320,028
Assets held in trust for pension benefits	<b>\$ 3,034,573,064</b>	<b>\$ 2,974,461,633</b>	<b>\$ 3,380,091,601</b>
Net investment income (loss)	\$ 381,460,272	\$ (140,449,682)	\$ 614,066,737
Contributions:			
Employee	7,799,790	9,538,384	10,453,905
Employer	-	49,760,229	81,642,112
Total contributions	7,799,790	59,298,613	92,096,017
Other income	21,741,155	2,108,976	768,132
Benefits paid to members and retirees:			
Retirees' pension and annuity benefits	279,885,732	278,104,785	263,432,423
Member annuity refunds and withdrawals	35,652,101	43,182,711	75,869,417
Total benefits paid	315,537,833	321,287,496	339,301,840
Benefits paid in excess of contributions	(307,738,043)	(261,988,883)	(247,205,823)
Ratio of benefits paid to contributions	40.5	5.4	3.7
Changes in estimate related to prior year contribution	29,026,800	-	-
Other expenses	6,325,153	5,300,379	5,486,680
Net increase (decrease) in net assets	<b>\$ 60,111,431</b>	<b>\$ (405,629,968)</b>	<b>\$ 362,142,366</b>

# **Police and Fire Retirement System of the City of Detroit**

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## **Management's Discussion and Analysis (Continued)**

### **Fund Overview, Membership, Governance**

The Police and Fire Retirement System of the City of Detroit (DPFRS or the "System") is a defined benefit pension plan and defined contribution plan. DPFRS exists to pay benefits to its active members, retirees, and beneficiaries. Active members earn service credit that entitles them to receive benefits in the future. Both the employer (the City of Detroit) and active members contribute to the System.

DPFRS is a relatively mature plan in that there are more retirees and beneficiaries receiving current benefits than active members. As of June 30, 2013, membership of the System consisted of 3,272 active members, 9,054 members receiving benefits, and 111 terminated plan members entitled to, but not yet receiving, benefits.

DPFRS is currently governed by a 16-member board of trustees (the "Board"). Six members of the Board are elected by the active membership to serve three-year terms. Expirations of terms of elected trustees are staggered. Two retired members are elected by the retired membership and serve three-year terms. Eight members serve ex-officio, these members being the mayor of the City of Detroit (or designee), the city treasurer (or deputy treasurer), one representative from the Detroit City Council, the Corporation Counsel (or designee), the finance director (or designee), and the budget director (or designee) and two ex-officio trustees to be appointed by the mayor. A 17<sup>th</sup> trustee may be selected to serve two years by the board of trustees who is not a participant of the plan and is not employed by the City.

### **Contributions to the System**

Both the City of Detroit (employer) and active employees make regular contributions to the System. Basic pension and disability benefits are funded through employer and employee contributions plus investment earnings on those contributions.

The required employer contributions are determined by the System's actuaries using the entry age normal cost method. Assumptions used by the actuaries are subject to experience testing every five years. During 2013, the System wrote off \$71,000,000 in receivables due from the City of Detroit. Approximately \$29,000,000 of those receivables relates to contributions that were never paid from fiscal year 2012. As a result, employer contribution revenue for fiscal year 2013 is zero. In addition, \$29,000,000 of the 2012 receivable write-off is shown in the 2013 financial statements as a change in estimate within the income statement.

# **Police and Fire Retirement System of the City of Detroit**

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## **Management's Discussion and Analysis (Continued)**

Active employees contribute 5 percent of pay up to the date at which they are eligible for retirement. Employee contributions are maintained in separate accounts in the defined contribution plan (annuity savings fund) solely for the benefit of the contributing employee. Employee annuity savings fund accounts are credited with investment earnings equal to the rate of return earned by the System subject to minimum earnings of 0 percent. An active employee may elect to withdraw his or her accumulated contributions plus investment earnings once he or she is eligible for retirement or upon completion of 25 years of service (DPOA and fire equivalents at 20 years).

### **Benefits Paid**

The System exists to pay the benefits which its members have earned. DPFRS paid out \$316 million in benefits during the year, consisting of \$280 million in benefits to retirees and beneficiaries plus \$36 million in refunds of annuity savings fund balances. This represents approximately 10 percent of the net assets of the System as of June 30, 2013. Employee contributions were \$7.8 million or 0.3 percent of the assets of the System. The excess of benefits over contributions is funded through investment income. The public capital markets represent the primary source of opportunities to earn investment income.

### **Asset Allocation**

The Board believes that the principal determinant of total fund investment performance over long periods of time is asset allocation. The DPFRS asset allocation is built upon the foundation that the obligations of DPFRS to pay the benefits promised to its members are very long-term obligations. Accordingly, the Board must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years. The Board must also balance the desire to achieve long-term gains with the requirements of having to raise the cash to fund significant benefit payments every month.

DPFRS has established asset allocation policies which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the Board's asset allocation as of June 30, 2013:

Equities	43.0%
Fixed income	25.5%
Real estate	15.5%
Alternative investments	15.0%
Cash	1.0%

State statutes impose limitations on what fraction of the total assets of the System may be invested in assets other than government bonds, investment-grade bonds, and certain mortgages. The Board's asset allocation policies comply with these limitations.



# **Police and Fire Retirement System of the City of Detroit**

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## **Management's Discussion and Analysis (Continued)**

### **Investment Results**

Effective with the fiscal year commencing July 1, 2003, DPFRS acquired the capability to calculate investment results on an AIMR-compliant, time-weighted, GIPS method basis. This capability is utilized to calculate investment results at the total fund composite, asset class composite, managed account, sector, and individual security levels. Investment results calculated for prior periods at the total fund composite level reflected dollar-weighted returns consistent with the methods utilized by the System's actuaries. Returns presented herein have been determined using the AIMR-compliant, time-weighted, GIPS method unless explicitly stated to the contrary. All returns for periods of one year or greater have been annualized.

### **Total Fund Composite**

The DPFRS total fund composite return for the year was 9.74 percent. Market returns across a broad set of asset classes were strong, with global public equity and particularly domestic (U.S.) equity as the top-performing assets segments. The DPFRS domestic and international equity portfolios returned 22 percent and 20 percent, respectively, for the fiscal year. The reversal of equity market declines from the previous year drove the average DPFRS portfolio return upward.

Now five years removed from the fiscal crisis, the DPFRS portfolio has, for the most part, recovered to its pre-crisis portfolio values, having benefited from double-digit returns in fiscal years 2010 and 2011, and the relatively flat fiscal year 2012. Total plan returns for the recent prior fiscal years ended June 30 are shown below:

2012	-1.5
2011	13.9
2010	16.9
2009	-14.8

### **Contacting the Police and Fire Retirement System of the City of Detroit**

This financial report is intended to provide a general overview of the System's finances and investment results in relation to actuarial projections. It shows the System's accountability for the money it receives from employer and employee contributions. If you have questions about this report or need additional information, we welcome you to contact the System's office.

# Police and Fire Retirement System of the City of Detroit

## Statement of Fiduciary Net Position

	June 30, 2013	June 30, 2012
<b>Assets</b>		
Cash and cash equivalents (Note 3)	\$ 39,561,392	\$ 8,470,026
Investments - At fair value (Note 3):		
Short-term investments	25,726,502	52,915,384
Stocks	1,546,808,302	1,369,740,351
Bonds	621,018,160	642,880,961
Mortgage-backed securities	76,038,940	79,033,706
Mortgage and construction loans	107,017,607	123,530,241
Equity interest in real estate	290,194,931	293,622,367
Real estate investment trusts held by custodian	23,523,860	41,072,094
Pooled investments	232,149,159	237,657,224
Private placements	85,647,423	84,185,928
Receivables:		
Accrued investment income	18,392,975	15,119,515
Contributions receivable	-	49,760,229
Other accounts receivable	353,595	1,065,750
Restricted assets - Amounts held in escrow	18,750,000	18,750,000
Cash and investments held as collateral for securities lending (Note 3):		
Asset-backed securities	11,932,958	26,316,561
Repurchase agreements	282,732,847	184,026,107
Money market	-	68,134
U.S. corporate floating rate	5,108,695	94,357,830
Agencies	-	5,000,497
Capital assets (Note 1)	1,234,407	1,274,497
Total assets	3,386,191,753	3,328,847,402
<b>Liabilities</b>		
Claims payable to retirees and beneficiaries	4,914,340	4,881,881
Payables for investment purchases	5,173,191	6,235,211
Amounts due broker under securities lending arrangements (Note 3)	320,998,625	336,556,836
Other liabilities	20,532,533	6,711,841
Total liabilities	351,618,689	354,385,769
<b>Net Position</b> - Held in trust for pension benefits (a schedule of analysis of funding progress is presented in the required supplemental information)	<u>\$ 3,034,573,064</u>	<u>\$ 2,974,461,633</u>

# Police and Fire Retirement System of the City of Detroit

## Statement of Revenues, Expenses, and Changes in Net Position

	Year Ended	
	June 30, 2013	June 30, 2012
<b>Additions</b>		
Investment income (loss):		
Interest and dividend income	\$ 96,336,483	\$ 105,065,300
Net appreciation (depreciation) in fair value	312,649,568	(228,705,779)
Less investment expense	(34,898,051)	(18,812,380)
Net investment income (loss)	374,088,000	(142,452,859)
Securities lending income:		
Income	1,808,690	1,788,635
Net gain on collateral pool	5,563,582	214,542
Net securities lending income	7,372,272	2,003,177
Contributions:		
Employer	-	49,760,229
Employee	7,799,790	9,538,384
Total contributions	7,799,790	59,298,613
Other income	21,741,155	2,108,976
Total additions - Net	411,001,217	(79,042,093)
<b>Deductions</b>		
Retirees' pension and annuity benefits	279,885,732	278,104,785
Member refunds and withdrawals	35,652,101	43,182,711
Changes in estimate related to prior year contribution	29,026,800	-
General and administrative expenses	6,250,704	5,188,593
Depreciation expense	74,449	111,786
Total deductions	350,889,786	326,587,875
<b>Net Increase (Decrease) in Net Position Held in Trust</b>	60,111,431	(405,629,968)
<b>Net Position Held in Trust - Beginning of year</b>	2,974,461,633	3,380,091,601
<b>Net Position Held in Trust - End of year</b>	<b>\$ 3,034,573,064</b>	<b>\$ 2,974,461,633</b>

# Police and Fire Retirement System of the City of Detroit

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## Notes to Financial Statements June 30, 2013

### **Note 1 - Summary of Significant Accounting Policies**

The City of Detroit (the "City") sponsors the contributory single-employer retirement plan for the Police and Fire Retirement System of the City of Detroit (the "System"). The System, which is administered by the System's board of trustees, is composed of a defined benefit component and a defined contribution component. The plans provide retirement, disability, and survivor benefits to plan members and beneficiaries. The Police and Fire Retirement System of the City of Detroit is a separate and independent trust qualified under applicable provisions of the Internal Revenue Code and is an independent entity (separate and distinct from the employer/plan sponsor) as required by (1) state law and (2) Internal Revenue Code provisions setting forth qualified plan status. The trustees of the plan have a fiduciary obligation and legal liability for any violations of fiduciary duties as independent trustees.

**Reporting Entity** - The financial statements of the System are also included in the combined financial statements of the City of Detroit as pension trust funds. The assets of the pension trust funds include no securities of or loans to the City or any other related party.

**Plan Sponsor Financial Condition** - The City of Detroit (the plan sponsor) is experiencing significant financial difficulty. During the prior year, the City entered into a Financial Stability Agreement with the State of Michigan which had put into place a financial advisory board, a chief financial officer, and a program management director to control the City's finances. The City had reported impending cash flow concerns. During FY 2013, the governor appointed an emergency manager under PA 72 of 1990. Subsequent to June 30, 2013, the City filed for bankruptcy, the eligibility for which was approved in December 2013 in federal court. As of June 30, 2013 the City of Detroit owes the System \$71,031,973 for past due actuarially determined contributions receivable, including approximately \$29,000,000 for the 2012 fiscal year and approximately \$42,000,000 related to fiscal year 2013. Part of the federal court's ruling in December 2013 indicated that the bankruptcy status usurps whatever protections may be offered governmental pensions under the Michigan Constitution. Based on these facts, there is significant uncertainty regarding the City's ability to meet its future financial obligations, including its ability to pay the current receivable as well as its ability to continue making future contributions to the System. As such, at June 30, 2013, an allowance was established for the entire \$71,000,000 in contributions receivable.

The System is currently pursuing an appeal in the Chapter 9 bankruptcy case challenging, among other things, the constitutionality of the City's eligibility for bankruptcy to the extent it diminishes or impairs the accrued pension benefits. If the System prevails on appeal and/or depending upon the terms of the bankruptcy settlement, the System may be entitled to payment of all or a portion of the delinquent 2012 and 2013 City employer contributions.

# Police and Fire Retirement System of the City of Detroit

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## Notes to Financial Statements June 30, 2013

### Note 1 - Summary of Significant Accounting Policies (Continued)

As a result of the City's weak financial condition, the City may recommend implementing benefit, pay, or plan design changes going forward. Such changes could significantly impact the plan's funded status and the calculation of the actuarial accrued liability on a go-forward basis.

**Basis of Accounting** - The Police and Fire Retirement System of the City of Detroit's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal, legally enforceable commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

#### Assets, Liabilities, and Net Position

**Methods Used to Value Investments** - Investments are reported at fair value or estimated fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments. The fair value of real estate investments is based on periodic appraisals as well as the judgment of independent real estate advisors and management. Investments that do not have an established market value are reported at estimated fair value as determined by the System's management.

Approximately \$722,000,000 or 24 percent of the System's net position as of June 30, 2013 and approximately \$750,000,000 or 25 percent of the System's net position as of June 30, 2012 are not publicly traded and therefore do not always have a readily determinable market value. Management's estimates of these values are based on information provided by investment managers, general partners, real estate advisors, and other means. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ significantly from the values that would have been used had a ready market for these securities existed. The difference could be material.

**Restricted Assets** - As part of one of its credit enhancement agreements (see Note 6), the City is required to set aside \$18,750,000 in a separate account in case of a borrower default. At June 30, 2013 and 2012, this amount has been shown as restricted assets - amounts placed in escrow.

**Capital Assets** - Capital assets for the System represent land, office equipment, and furniture. Depreciation expense is calculated by allocating the net cost of the assets over their estimated useful lives.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 1 - Summary of Significant Accounting Policies (Continued)

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure. Actual results could differ from those estimates.

**Reclassifications** - Comparative data for the prior year has been reclassified in order to be consistent with the current year's presentation.

**Reporting Change** - During the year, the System adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The statement incorporates deferred outflows of resources and deferred inflows of resources, as defined by GASB Concepts Statement No. 4, into the definitions of the required components of the residual measure of net position, formerly net assets. The statement also provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. For the System, GASB 63's impact is limited to changing the terminology "net assets" to "net position".

### Note 2 - Pension Description and Contribution Information

At June 30, 2013, the membership of the defined benefit plan and the defined contribution plan consisted of the following:

	Defined Benefit Plan	Defined Contribution Plan
Retirees and beneficiaries receiving pension benefits	9,054	655
Terminated plan members entitled to, but not yet receiving, benefits	111	24
Active plan members	3,272	2,998

**Plan Description** - The System provides retirement benefits as well as survivor and disability benefits. Employees may receive cost-of-living adjustments as a percentage of their base amounts, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by the City Charter and negotiation with the employees' collective bargaining unit. However, given the bankruptcy filing, the obligation to make future contributions is uncertain.

# Police and Fire Retirement System of the City of Detroit

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## Notes to Financial Statements June 30, 2013

### Note 2 - Pension Description and Contribution Information (Continued)

**Contributions** - The City's policy, prior to the bankruptcy filing, was to fund normal costs and amortization of prior service costs. The City previously contributed at an actuarially determined rate. Administrative costs are financed through investment earnings.

The contribution rate calculated by the actuary for 2012-2013 fiscal year and 2011-2012 fiscal year was 23.14 and 23.02 percent, respectively, of active member annual covered payroll. This results in an actuarially required contribution of \$42,005,173 and \$49,760,229 for the two years, respectively. As discussed in Note 1, as of June 30, 2013, the City still owed the System approximately \$29,000,000 of the fiscal year 2011-2012 employer contributions outstanding and all of the fiscal year 2012-2013 employer contributions. The System has established a 100 percent reserve for these amounts due to the uncertainties surrounding collection pending the results of the City's bankruptcy proceedings.

Employees are required to make contributions toward annuity savings in the amount of 5 percent of base compensation until eligibility for retirement is reached. Contributions from employees totaled \$7,799,790 and \$9,538,384 for the years ended June 30, 2013 and 2012, respectively. The contribution requirements of plan members and the City of Detroit are established and may be amended by the board of trustees in accordance with the City Charter, union contracts, and plan provisions.

**Annual Pension Cost** - The annual pension cost and annual required contribution for the year ended June 30, 2013 was \$42,005,173. This amount remains unpaid at June 30, 2013 and will be recognized as revenue by the System if and when it is paid by the City.

The annual contribution was determined as part of an actuarial valuation at June 30, 2011, using the entry age cost method. Significant actuarial assumptions used include (a) an 8.0 percent investment rate of return, (b) projected salary increases of 0.0 percent to 4.0 percent per year, due to inflation, (c) additional salary increases of 1.0 percent to 5.2 percent per year based on merit and/or longevity, and (d) cost-of-living adjustments for certain members of 2.25 percent per year. The 8.0 percent investment rate of return is determined using techniques that smooth the effects of short-term volatility over a seven-year period and include an inflation component of 4.0 percent. The unfunded actuarial liability is being amortized as a level dollar of payroll. The remaining amortization period is 29 years.

# **Police and Fire Retirement System of the City of Detroit**

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## **Notes to Financial Statements June 30, 2013**

### **Note 2 - Pension Description and Contribution Information (Continued)**

Related to the June 30, 2012 valuation, all assumptions were consistent with those used for the June 30, 2011 valuation. The 2012 valuation assumes that the plan sponsor will make all required contributions when due. The actuarial valuation would not have taken into consideration the ability of the plan sponsor to make contributions when due. Assumptions and methods that will be used in future valuations are contingent on the future status of the System which is unusually uncertain due to the bankruptcy filing.

**Funded Status and Funding Progress** - As of June 30, 2012, the most recent actuarial valuation date, the plan was 96.1 percent funded on an actuarial basis. The actuarial accrued liability for benefits was \$3,822,676,002 and the actuarial value of assets was \$3,675,459,604, resulting in underfunding of \$147,216,398. The covered payroll (annual payroll for active employees covered by the plan) was \$205,800,278. On a market value basis, the plan was approximately 78 percent funded as of June 30, 2012.

The actuarial accrued liability is extremely sensitive to the underlying investment rate of return assumption, which is set at 8 percent. Any downward movement in that estimate will have the impact of increasing the actuarial accrued liability and therefore also lowering the funded status of the plan.

The schedule of funding progress, presented as required supplemental information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

### **Note 3 - Deposits and Investments**

The System is authorized by Michigan Public Act 347 of 2012 to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The investment policy adopted by the Board is in accordance with Public Act 196 of 1997 and has authorized investments according to Michigan Public Act 347 of 2012. The System's deposits and investment policies are in accordance with statutory authority.

The System invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks, and overall market volatility. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported on the statement of changes in plan net position.



# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

The System's cash and investments are subject to several types of risk, which are examined in more detail below:

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the System's deposits may not be returned to it. The System does not have a deposit policy for custodial credit risk. Approximately \$21.0 million of the System's checking account balances was uninsured and uncollateralized at June 30, 2013. The System had no bank deposits (certificates of deposit, checking, and savings accounts) at June 30, 2012 that were uninsured and uncollateralized. The System believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the System evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

**Interest Rate Risk** - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System's investment policy does not restrict investment maturities.

At June 30, 2013, the average maturities of debt investments are as follows:

Investment Type	Fair Value (in thousands)	Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years
U.S. government	\$ 152,847	\$ 13,522	\$ 42,441	\$ 9,164	\$ 87,720
Government assets and mortgage backed	48,743	-	2,524	4,362	41,857
Treasuries, including futures	1,572	1,369	(49)	391	(139)
Corporate**	346,879	13,668	124,144	170,236	38,831
Private placement	132,171	4,421	44,024	70,850	12,876
Convertible bonds	25,772	3,479	10,197	5,093	7,003
State and local obligations	5,772	-	-	5,772	-
Convertible preferred stock	9,698	9,130	-	-	568
Construction loans	1	-	1	-	-
Mortgages	106,392	-	106,392	-	-
Total	<u>\$ 829,847</u>	<u>\$ 45,589</u>	<u>\$ 329,674</u>	<u>\$ 265,868</u>	<u>\$ 188,716</u>

\*\* Not all pooled, mutual funds, corporate, and commingled bonds are subject to interest rate risk.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

At June 30, 2012, the average maturities of investments are as follows:

Investment Type	Fair Value (in thousands)	Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years
U.S. government	\$ 160,694	\$ 3,571	\$ 46,388	\$ 8,543	\$ 102,192
Government assets and mortgage backed	45,551	983	1,070	1,275	42,223
Treasuries	5,673	5,700	(3)	(36)	12
Corporate**	377,974	12,688	121,889	203,888	39,509
Private placement	127,175	5,325	46,021	66,449	9,380
Convertible bonds	27,922	2,707	14,744	2,132	8,339
State and local obligations	5,249	440	-	4,527	282
Convertible preferred stock	9,815	8,612	560	-	643
Construction loans	7,994	7,994	-	-	-
Mortgages	115,536	8,888	106,648	-	-
Total	\$ 883,583	\$ 56,908	\$ 337,317	\$ 286,778	\$ 202,580

\*\* Not all pooled, mutual funds, corporate, and commingled bonds are subject to interest rate risk.

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System has no investment policy that would further limit its investment choices.

As of June 30, 2013, the credit quality ratings of debt securities (other than the U.S. government) as rated by Moody's are as follows:

Investment Type and Fair Value (in Thousands)	AAA	AA	A	BAA	BA	B	CAA and Below	NR
Corporate fixed income	\$ 40,136	\$ 21,664	\$ 88,655	\$ 111,218	\$ 27,177	\$ 59,878	\$ 16,806	\$ 40,804
Government fixed income	146,357	1,381	-	-	-	-	-	-
Private placements	6,100	3,815	3,807	18,831	15,586	46,364	17,889	10,708
Convertible bonds	-	-	2,164	1,658	1,177	1,617	-	19,321
Future contracts	-	-	-	-	-	-	-	203
Mortgages	-	-	-	-	-	-	-	1,156
Preferred securities	-	-	-	2,085	427	727	-	7,158
Convertible preferred stock	-	-	-	533	114	-	-	2,890
Convertible private placements	-	-	-	-	226	557	-	7,588
Construction loans	-	-	-	-	-	-	-	1
Total	\$ 192,593	\$ 26,860	\$ 94,626	\$ 134,325	\$ 44,707	\$ 109,143	\$ 34,695	\$ 89,829

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

As of June 30, 2012, the credit quality ratings of debt securities (other than the U.S. government) as rated by S&P are as follows:

Investment Type and Fair Value (in Thousands)	AAA	AA	A	BBB	BB	B	CCC and Below	NR
Corporate fixed income	\$ 31,343	\$ 21,105	\$ 99,595	\$ 103,900	\$ 36,783	\$ 73,249	\$ 12,588	\$ 45,021
Government fixed income	-	156,768	1,627	2,128	164	358	-	2,044
Private placements	2,839	4,323	7,392	18,254	22,904	42,538	11,695	6,448
Convertible bonds	-	-	6,853	8,387	4,575	3,625	-	4,482
Mortgages	-	-	-	-	-	-	-	115,536
Convertible preferred stock	-	-	-	6,384	643	-	-	2,789
Preferred stock	-	-	-	-	933	-	-	2,184
Convertible private placements	1,056	-	486	2,794	777	1,120	-	4,501
Construction loans	-	-	-	-	-	-	-	7,994
Total	<u>\$ 35,238</u>	<u>\$ 182,196</u>	<u>\$ 115,953</u>	<u>\$ 141,847</u>	<u>\$ 66,779</u>	<u>\$ 120,890</u>	<u>\$ 24,283</u>	<u>\$ 190,999</u>

**Foreign Currency Risk** - Foreign currency risk is the risk that an investment denominated in the currency of a foreign country could reduce its U.S. dollar value as a result of changes in foreign currency exchange rates. The System does not restrict the amount of investments in foreign currency.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

At June 30, 2013, the following securities are subject to foreign currency risk (in thousands):

	Equity	Forward Contracts (Including Payable/ Receivable)	Cash	Net Investment Receivable/ (Payable)
Australian dollar	\$ 11,439	\$ 3,557	\$ 62	\$ 144
Brazilian real	866	-	18	-
British pound sterling	66,701	3,841	132	120
Canadian dollar	20,256	2,142	713	(45)
Danish krone	4,889	(95)	78	(153)
Euro currency	97,886	(1,969)	5,073	(1,166)
Hong Kong dollar	13,840	1,080	241	90
Indian rupee	347	-	-	-
Indonesian rupiah	791	-	1	-
Israeli shekel	1,573	462	126	-
Japanese yen	88,128	(18,474)	922	(680)
Malaysian ringgit	344	-	-	-
New Taiwan dollar	2,191	-	600	-
New Turkish lira	187	-	2	-
New Zealand dollar	295	-	9	-
Norwegian krone	6,753	748	61	22
Philippines peso	-	-	9	-
Russian new ruble	1,349	-	-	-
Singapore dollar	2,717	600	15	9
South African rand	645	-	5	-
South Korean won	3,963	(161)	-	161
Swedish krona	4,304	2,814	23	17
Swiss franc	39,419	(5,289)	620	(307)
Thai baht	237	-	-	-
Total	<u>\$ 369,120</u>	<u>\$ (10,744)</u>	<u>\$ 8,710</u>	<u>\$ (1,788)</u>

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

At June 30, 2012, the following securities are subject to foreign currency risk (in thousands):

	Equity	Forward Contracts (Including Payable/ Receivable)	Cash	Fixed Income
Australian dollar	\$ 8,889	\$ 1,183	\$ 83	\$ 13
Brazilian real	1,132	-	15	-
British pound sterling	76,732	(68)	80	380
Canadian dollar	19,512	3,767	123	(32)
Danish krone	4,995	(1,282)	74	(140)
Euro currency	88,532	(7,819)	6,771	(283)
Hong Kong dollar	11,107	(225)	38	12
Indian rupee	190	-	-	-
Indonesian rupiah	565	-	-	-
Israeli shekel	833	415	58	-
Japanese yen	47,319	(6,166)	703	(661)
Malaysian ringgit	348	(4)	-	4
Mexican nuevo peso	163	-	-	-
New Taiwan dollar	445	-	601	-
New Zealand dollar	23	-	6	-
Norwegian krone	4,213	633	69	-
New Turkish lira	-	-	2	-
Philippines peso	380	-	-	-
Russian new ruble	546	-	-	-
Singapore dollar	2,717	1,321	48	-
South African rand	838	-	2	-
South Korean won	577	-	-	-
Swedish krona	6,205	2,201	36	-
Swiss franc	24,240	(897)	486	92
Thai baht	594	-	-	-
Total	<u>\$ 301,095</u>	<u>\$ (6,941)</u>	<u>\$ 9,195</u>	<u>\$ (615)</u>

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

As permitted by state statutes and under the provisions of a securities lending authorization agreement, the System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The System's custodial bank manages the securities lending program and receives cash, government securities, or irrevocable bank letters of credit as collateral. The custodial bank does not have the ability to pledge or sell collateral securities unless the borrower defaults. Borrowers are required to deliver collateral for each loan equal to not less than 102 percent of the market value of the loaned securities.

As of June 30, 2013, the collateral provided was 103.98 percent of the market value of the loaned securities.

The System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank.

The System and the borrower maintain the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested together with the cash collateral of other lenders in an investment pool. The average duration of this investment pool as of June 30, 2013 and 2012 was two days and 15 days, respectively. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On June 30, 2013 and 2012, the System had no credit risk exposure to borrowers. The collateral held (at cost) and the fair market value of underlying securities on loan for the System as of June 30, 2013 were \$320,998,625 and \$308,701,835, respectively.

The following represents the balances relating to the securities lending transactions as of June 30, 2013; investments are reported at fair value:

<u>Securities Lent</u>	<u>Underlying Securities</u>
U.S. government and agencies	\$ 17,999,415
U.S. corporate fixed income	34,803,200
U.S. equities	235,065,974
Non-U.S. equities	20,833,246
Total	<u>\$ 308,701,835</u>

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

The fair market value of the collateral pool related to securities lending at June 30, 2013 was \$299,774,500. The investments were in agencies, asset-backed securities, notes (floating rate), money funds, and repurchase agreements. Approximately 97 percent of these securities had a duration of less than one year and 3 percent had a duration over 15 years.

The credit ratings of the securities lending collateral pool held at June 30, 2013 as rated by S&P are as follows:

<u>Ratings</u>	<u>Amount</u>
AAA	\$ 2,406,257
AA	4,008,616
A	1,100,079
B	702,907
CCC	8,834,424
NR	<u>282,722,217</u>
Total	<u>\$ 299,774,500</u>

The collateral held (at cost) and the fair market value of underlying securities on loan for the System as of June 30, 2012 were \$336,556,836 and \$336,533,472, respectively.

The following represents the balances relating to the securities lending transactions as of June 30, 2012; investments are reported at fair value:

<u>Securities Lent</u>	<u>Underlying Securities</u>
U.S. government and agencies	\$ 11,563,082
U.S. corporate fixed income	40,892,376
U.S. equities	266,012,477
Non-U.S. equities	<u>18,065,537</u>
Total	<u>\$ 336,533,472</u>

The fair market value of collateral of the securities lending at June 30, 2012 was \$309,769,129. The investments were in agencies, asset-backed securities, notes, (floating rate), money funds, and repurchase agreements. Approximately 93 percent of these securities had a duration of less than one year, 3 percent had a duration between 1-5 years, and 4 percent had a duration over 15 years.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2013

### Note 3 - Deposits and Investments (Continued)

The credit ratings of the securities lending collateral pool held at June 30, 2012 as rated by S&P are as follows:

<u>Ratings</u>	<u>Amount</u>
AAA	\$ 19,028,459
AA	53,660,608
A	31,826,999
B	1,455,869
BBB	2,993,454
CCC	8,501,712
NR	<u>192,302,028</u>
Total	<u>\$ 309,769,129</u>

### Note 4 - Reserves

The plan requires that employee contributions be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of June 30, 2013 and 2012, these reserves were less than the net assets of the Plan.

	<u>2013</u>	<u>2012</u>
Reserved for employee contributions	\$ 178,231,705	\$ 198,566,556
Reserved for retired employees	2,934,019,383	2,822,235,617

A statement of changes in plan net position by sub-fund is included in the other supplemental information.



# **Police and Fire Retirement System of the City of Detroit**

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## **Notes to Financial Statements June 30, 2013**

### **Note 5 - Pension Obligation Certificates**

In June 2005, the City of Detroit issued \$1,440,000,000 of pension obligation certificates to provide funding for the unfunded actuarially accrued liability (UAAL) which existed at June 30, 2003 in both the General Employees' Retirement System of the City of Detroit and the Police and Fire Retirement System of the City of Detroit. The understanding was that any future UAAL that may arise would continue to be paid by the City, as well as the annual normal cost. The proceeds of the pension obligation certificates were deposited into the systems and are accounted for in the Accrued Liability Fund (pension obligation certificate reserve). Approximately \$740,000,000 was deposited into the General Employees' Retirement System of the City of Detroit and approximately \$630,000,000 was deposited into the Police and Fire Retirement System of the City of Detroit, net of issuance costs and premiums. On an annual basis, funds will be transferred from the Accrued Liability Fund reserve to the pension accumulation reserve based on a computation performed by the City of Detroit. The Accrued Liability Fund was credited with investment earnings commensurate with the overall earnings of the System.

### **Note 6 - Credit Enhancement Agreements and Funding Commitments**

The System had an outstanding credit enhancement agreement totaling \$15,000,000 during both 2013 and 2012. In exchange for the credit enhancement, the System receives fees from the company to which the enhancement agreements have been given. As a part of the credit enhancement agreement, the System was required to maintain a minimum balance with the lending agency and has restricted cash in the amount of \$18,750,000 as of June 30, 2013 and 2012.

During the fiscal year, the System determined that the original borrower under the credit enhancement agreement would be unable to make the payments to the lending agency; therefore, the System has now reported a liability for \$15,000,000 as of June 30, 2013 representing the underlying obligation that the System has guaranteed. This liability has been reflected in the financial statements within the other liability balances.

When the System enters into various investments, it may not completely fund the entire investment at the beginning. Rather, it enters into commitments to fund remaining capital amounts at certain points in time. At June 30, 2013 and 2012, the remaining capital funding commitment for the System is approximately \$25 million and \$29 million, respectively.

# **Police and Fire Retirement System of the City of Detroit**

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## **Notes to Financial Statements June 30, 2013**

### **Note 7 - Upcoming Accounting Pronouncements**

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is required to be implemented for financial statements for periods beginning after December 15, 2012. Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows and inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources. Statement No. 65 will be implemented for the System as of June 30, 2014.

In June 2012, GASB Statement No. 67, *Financial Reporting for Pension Plans*, was issued by the Governmental Accounting Standards Board. This new standard, which replaces the requirements of GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, establishes standards for financial reporting that outline the basic framework for separately issued pension plan financial reports and specifies the required approach to measuring the liability of employer(s) and certain nonemployer contributing entities, about which information is required to be disclosed. GASB Statement No. 67 is required to be adopted for years beginning after June 15, 2013. For the Police and Fire Retirement System of the City of Detroit, this standard will be adopted for the year ending June 30, 2014.

## **Required Supplemental Information**

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# Police and Fire Retirement System of the City of Detroit

## Required Supplemental Information Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/07	\$ 4,307,183,758	\$ 3,896,814,229	\$ (410,369,529)	110.5 %	\$ 230,173,964	- %
6/30/08	4,316,263,291	4,071,053,752	(245,209,539)	106.0	232,812,606	-
6/30/09	3,945,205,453	4,221,291,045	276,085,592	93.5	231,795,528	119.1
6/30/10	3,853,279,381	3,767,364,201	(85,915,180)	102.3	228,829,999	-
6/30/11	3,804,759,868	3,808,642,533	3,882,665	99.9	220,461,691	1.8
6/30/12	3,675,459,604	3,822,676,002	147,216,398	96.1	205,800,278	71.5

# Police and Fire Retirement System of the City of Detroit

## Required Supplemental Information Schedule of Employer Contributions

Year Ended June 30	Annual Required Contribution	Contribution Made	Percentage Contributed	Transfer from Accrued Liability Reserve *
2008 **	\$ 58,934,636	\$ 41,113,934	70 %	\$ 34,074,039
2009 **	61,151,057	36,151,057	59	36,791,369
2010 **	57,808,485	32,808,485	57	41,403,282
2011	81,642,112	81,642,112	100	43,874,394
2012 ***	49,760,229	20,733,429	42	46,626,990
2013***	42,005,173	-	-	49,399,867

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of June 30, 2012, the latest actuarial valuation date, follows:

Valuation date	June 30, 2012
Actuarial cost method	Entry age
Amortization method	Level dollar, closed
Remaining amortization period	29 years
Asset valuation method	7-year smoothed market
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases ****	5.0%-9.2%
**** Includes inflation at	0% for two years; 4% thereafter
Cost of living adjustments	2.25%

\* In accordance with the pension obligation certificate requirements, annual transfers are made from the Accrued Liability Fund to the pension accumulation reserve for the amortization of the unfunded liability that existed at the date the certificates were issued.

\*\* For the years ended June 30, 2010, 2009, and 2008, the System gave various credits to the City that offset the required contributions.

\*\*\* As of June 30, 2013, a portion of the 6/30/2012 annual required contribution and the entire 6/30/2013 annual required contribution has not been paid and has not been recognized as revenue given the City's bankruptcy.

## **Other Supplemental Information**

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# Police and Fire Retirement System of the City of Detroit

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## Other Supplemental Information Description of Funds

**Annuity Savings Fund** - This fund represents cumulative required and voluntary contributions made by the active employees plus accumulated interest.

**Annuity Reserve Fund** - Transfers are made from the Annuity Savings Fund into the Annuity Reserve Fund when an employee retires, becomes disabled, or if a surviving spouse elects an annuity rather than a lump-sum payout of accumulated employee contributions.

Both annuity funds are referred to as defined contribution plans.

**Market Stabilization Fund** - This fund represents designations from the plans' investment income (loss) to be used to cushion the market value adjustments within the other funds. The board of trustees authorized the creation of this fund and the reserve amounts are calculated using a three-year average method.

**Accrued Liability Reserve Fund** - This fund originated during June 2005 when the City issued pension obligation certificates to fund the unfunded actuarial accrued liability that existed at June 30, 2003 (subject UAAL). On an annual basis, the actuary will inform the System of the amount to transfer from the accrued liability reserve to the Pension Accumulation Fund in lieu of contributions from the City for the subject UAAL.

**Survivor Benefits Fund** - This fund is used to accumulate the DPFRS employee and City contributions for certain survivor benefits from which the related benefits are paid.

**Pension Accumulation Fund** - This fund represents accumulated City contributions to the System for the payment of pensions and other benefits to future retirees. Additionally, pre-employment military service credit contributions are captured in this fund.

**Pension Reserve Fund** - This fund represents funded pension benefits available for retired members and is funded by actuarially determined transfers from the Pension Accumulation Fund.

# Police and Fire Retirement System of the City of Detroit

	Annuity Reserves			
	Annuity Savings Fund	Annuity Reserve Fund	Market Stabilization Fund	Accrued Liability Reserve Fund
<b>Additions</b>				
Net investment income (loss)	\$ 11,551,771	\$ 1,531,772	\$ 238,490,803	\$ 55,706,250
Contributions:				
Employer	-	-	-	-
Employee	7,799,790	-	-	-
Total additions - Net	19,351,561	1,531,772	238,490,803	55,706,250
<b>Deductions</b>				
Retirees' pension and annuity benefits	-	-	-	-
Member refunds and withdrawals	35,652,101	-	-	-
Depreciation expense	-	-	-	-
General and administrative expenses	-	-	-	-
Total deductions	35,652,101	-	-	-
<b>Net (Deductions) Additions - Before transfers</b>	(16,300,540)	1,531,772	238,490,803	55,706,250
<b>Transfers - Net</b>	(4,034,311)	3,945,811	-	(49,399,867)
<b>Net (Decrease) Increase in Net Position Held in Trust for Pension Benefits</b>	(20,334,851)	5,477,583	238,490,803	6,306,383
<b>Net Position Held in Trust for Pension Benefits - Beginning of year</b>	198,566,556	17,260,868	(696,328,119)	694,971,515
<b>Net Position Held in Trust for Pension Benefits - End of year</b>	<u>\$ 178,231,705</u>	<u>\$ 22,738,451</u>	<u>\$ (457,837,316)</u>	<u>\$ 701,277,898</u>



**Other Supplemental Information**  
**Statement of Changes in Plan Net Position by Fund**  
**Year Ended June 30, 2013**  
**(with comparative totals for the year ended June 30, 2012)**

Pension Reserves			Total	
Survivor Benefits Fund	Pension Accumulation Fund	Pension Reserve Fund	2013	2012
\$ 223,875	\$ (126,334,770)	\$ 222,031,726	\$ 403,201,427	\$ (138,340,706)
-	(29,026,800)	-	(29,026,800)	49,760,229
-	-	-	7,799,790	9,538,384
223,875	(155,361,570)	222,031,726	381,974,417	(79,042,093)
-	-	279,885,732	279,885,732	278,104,785
-	-	-	35,652,101	43,182,711
-	74,449	-	74,449	111,786
-	6,250,704	-	6,250,704	5,188,593
-	6,325,153	279,885,732	321,862,986	326,587,875
223,875	(161,686,723)	(57,854,006)	60,111,431	(405,629,968)
-	(114,671,822)	164,160,189	-	-
223,875	(276,358,545)	106,306,183	60,111,431	(405,629,968)
5,596,867	(50,580,803)	2,804,974,749	2,974,461,633	3,380,091,601
<b>\$ 5,820,742</b>	<b>\$ (326,939,348)</b>	<b>\$ 2,911,280,932</b>	<b>\$ 3,034,573,064</b>	<b>\$ 2,974,461,633</b>

December 19, 2013

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

We have audited the financial statements of the Police and Fire Retirement System of the City of Detroit (the "System") as of and for the year ended June 30, 2013 and have issued our report thereon dated December 19, 2013. Professional standards require that we provide you with the following information related to our audit which is divided into the following sections:

Section I - Communications Required Under AU 265

Section II - Communications Required Under AU 260

Section III - Legislative and Informational Items

Section I includes any deficiencies we observed in the System's accounting principles or internal control that we believe are significant. Current auditing standards require us to formally communicate annually matters we note about the System's accounting policies and internal control.

Section II includes information that current auditing standards require independent auditors to communicate to those individuals charged with governance. We will report this information annually to the board of trustees of the Police and Fire Retirement System of the City of Detroit.

Section III contains updated legislative and informational items that we believe will be of interest to you.

We would like to take this opportunity to thank the System's staff for the cooperation and courtesy extended to us during our audit.

This report is intended solely for the use of the board of trustees and management of the Police and Fire Retirement System of the City of Detroit and is not intended to be and should not be used by anyone other than these specified parties.

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

December 19, 2013

We welcome any questions you may have regarding the following communications and we would be willing to discuss any of these or other questions that you might have at your convenience.

Very truly yours,

**Plante & Moran, PLLC**

A handwritten signature in black ink that reads "Beth Bialy". The script is cursive and fluid.

Beth A. Bialy

A handwritten signature in black ink that reads "Michelle Watterworth". The script is cursive and fluid.

Michelle M. Watterworth

## **Section I - Communications Required Under AU 265**

In planning and performing our audit of the financial statements of the Police and Fire Retirement System of the City of Detroit (the "System") as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and another deficiency that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

We consider the following deficiencies in the System's internal control to be material weaknesses:

### **Controls and Procedures Related to Cash and Investments at Bank of New York**

- **Timeliness and Review of Investment Reconciliations** - The System has approximately \$2.3 billion at Bank of New York (BONY) in various investments. At the end of every month, the System should be reconciling the amounts at the bank with the amounts recorded in the System's general ledger. In addition, these reconciliations, prepared by the principal accountant, should be reviewed in detail and approved by the head accountant. The preparation and review of investment reconciliations are imperative to ensure that the transactions recorded by the System match the transactions actually recorded at the bank and serve as a key control to ensure that the financial reports generated by the System are accurate.

During fiscal year 2012, the System switched platforms at Bank of New York, which caused the System staff to have problems in performing these reconciliations on a timely basis during 2012, resulting in delays. During the current fiscal year, the System made an attempt to keep up with the reconciliations but was unable to do so due to issues with the format of reports received from BONY. As a result, the System continued to fall behind on this reconciliation process during fiscal year 2013, ultimately not completing all months' reconciliations until November 2013. The lack of timely reconciliation procedures could lead to misappropriation of assets that are not detected timely and ultimately to inaccuracies with financial reporting on a monthly and annual basis. We urge you to continue to focus on timely preparation of these reconciliations in addition to ensuring these reconciliations and the related journal entries are being reviewed (in detail) after preparation.

- **Review of BONY Pricing** - BONY is the primary custodian for the System for all non-alternative investments. A portion of what the System relies on BONY to do is value this non-alternative investment portfolio. For the most part, the investments held at BONY are easy-to-value assets with prices readily available from publicly published sources. However, BONY does hold certain investments that are not as easy to value and therefore, there is an increased risk that the valuation provided by BONY may not be accurate. The System has a fiduciary responsibility to ensure that the values BONY is assigning, and therefore the figures the System is using, really do represent fair value. In order to do this, the System should be performing sample tests on the values of these investments to ensure that BONY's pricing is appropriately reflective of market value and that the underlying data is available to support these assessments. Absent this control, the System really has no assurances that BONY's pricing is in accordance with GAAP nor can the System attest that this pricing is verifiable.
- **Administering Access to BONY** - With the new workbench platform that was introduced by BONY in November 2011, certain individuals have been given access to the BONY accounts and, based on their responsibilities at the System, the level of access could range from "read-only" access to having the ability to initiate transfers. During the year, it was noted that an individual with access to BONY accounts was terminated from employment with the System, yet the System did not have any documentation to support that a written communication from an authorized person was sent to BONY to disable the individual's access. In order to reduce the risk of unauthorized access to BONY accounts, we recommend that the System establish procedures with the bank to determine a list of authorized individuals who would be the only individuals with the ability to add a new user, disable, change, or remove the access rights of an existing user.

### **Controls and Processes Over the Recording of Alternative Investments**

The System has made some significant progress as it relates to obtaining more appropriate fair market valuations of its alternative investments. However, much work remains to be done to ensure the System's controls and processes in this area reliably prevent or detect errors up to and including recording those investments in the System's general ledger. The following are some specific areas that merit attention by the System:

- **Recording Alternative Investments on the Trial Balances** - During the prior year audit, the System put a process in place to communicate the results of those valuations prepared by the investment analyst to the accounting staff so appropriate adjustments could be made in the System's general ledger. In the current year, the System continued using a similar process. However, it continues to be noted that there is no follow-up in place to ensure that the adjustments communicated by the investment analyst are actually made by the accounting staff and no follow-up to ensure those adjustments are made accurately. We found numerous instances during the audit where the lack of this follow-up resulted in errors that we identified related to the System's financial statements. Without this formal process being put in place, the System cannot reliably prevent errors in its financial statements. The System should establish a mechanism whereby someone other than the preparers of the journal entries are reconciling the trial balances against the information provided by the investment analyst.
- **Bank Accounts Associated with Alternative Investments** - Several of the LLCs that were created for the various real estate alternative investments owned 100 percent by the System that are now managed by American Realty Advisors (ARA) have separate bank accounts that are also managed by ARA. The transactions running through these accounts are primarily the monthly rental payments from the tenants and the monthly operating expenses. ARA is providing the System with copies of the bank statements as well as the bank reconciliations and check registers. The System currently is not reviewing this activity. In order to ensure that the System is appropriately monitoring these funds, the System needs to add this review to its periodic controls. Absent these additional controls, transactions could be occurring within the bank accounts that have not been authorized by the System.

In addition, these bank accounts with which ARA has custody are subject to an annual surprise audit by an external accounting firm, the scope of which is dictated by the parameters of the Investment Advisors Act of 1940. As part of the audit, the accounting firm will issue a report regarding its findings to the SEC, the results of which the System should closely monitor.

### **Controls Over the System's Census Data and Actuarial Valuation Process**

The System has to accumulate and transmit voluminous member data to the actuary. The actuary then uses this information to prepare the actuarial valuation which impacts the calculation of the annual required contribution (ARC) and the actuarial accrued liability (AAL). It is key that the information that is provided to the actuary is complete and accurate in order to ensure that the ARC and AAL are also accurate.

- **Controls Over Actuarial Reporting** - The System provides information on an annual basis to the actuary in order for the actuary to compute the actuarial accrued liability as well as the annual required contribution. The information provided by the System includes data for all participants in the System, such as pay information, date of birth, date of hire, etc. and enables the actuary to project the present value of future benefit payments. Prior to providing the information to the actuary, the System does perform certain tests on the data. However, during our testing, we noted several instances of errors in the data or missing data that resulted in incomplete information. We encourage the System to put in place more comprehensive procedures to further ensure the accuracy of this census data being used by the actuary.

Once the information is provided to the actuary, the System does very little to verify that the actuary actually did use the same census information that was originally provided. There are some very high-level procedures the System should undertake to ensure that the ultimate reporting by the actuary encompasses the totality of the information the System actually provided.

- **Controls over Changes to Benefits or Plan Terms** - In the past few years, the City of Detroit (Plan Sponsor) has initiated several changes to employee contracts and some of these changes have a significant impact on the present value of future benefit payments, as calculated by the actuary. Currently, the procedures in place to communicate those changes to the actuary are not very strong and could result in either a miscommunication of changes or potentially the omission of communication regarding certain changes which may result in a materially inaccurate actuarial valuation. In addition to establishing strong controls and procedures to communicate and document these changes, the System should take a close look at the actuarial valuation to ensure that the actuary actually has taken into account all such changes (even if these changes were initiated after year end but before the actuarial valuation is ready) prior to finalizing the report.

### **Controls Over the System's Information Technology Processes**

The System has a complex modifiable information technology system that integrates with the City's various payroll databases. The System's IT department is independent of the City and the System's other departments. The security provided by the IT System is important to the validity and the accuracy of the data maintained (including the general ledger).

- **Access Termination** - The System has several employees that have different access rights to the various applications and modules (including the databases used to maintain census information, benefits history, email, and the general ledger) that are used at the System. The System should monitor the access to these modules to ensure that only individuals who have been granted the rights are accessing these modules. Additionally, the user access for any individuals whose employment with the System has been terminated or whose responsibilities at the System have changed, should be disabled or changed immediately by an authorized individual to ensure that there is no unauthorized access. Without limiting unauthorized access, the integrity of the underlying data is at significant risk. We urge the System to implement controls and processes to initiate such procedures immediately after a termination or change in an individual's position has occurred.
- **Change Management** - The System uses customized software which is managed internally by the System's IT personnel and can be modified by the IT department. For all changes to that software, there should be an automated log maintained listing those changes and no single individual should be able to effect a change without proper authorization. It is recommended that the System implement processes to ensure that master file changes are documented, authorized, and reviewed. The lack of this documentation could result in unauthorized and undocumented changes that go undetected by the System.

#### **Other Controls Over the System's Financial Reporting Process**

- **Access to Financial Applications** - During the process of reviewing the controls underlying the IT system, it was noted that individuals with full administrative access to network applications also have the ability to post transactions in the general ledger. In order to ensure that only authorized individuals post transactions in the general ledger, the System should either limit general ledger access to only authorized individuals or put in place a process whereby all transaction logs are reviewed by someone outside of IT in detail on a monthly basis.



- **First Independence Bank Activity** - The System has multiple accounts at First Independence Bank. These accounts are used to process and receive payments related to retiree benefit payments, regular accounts payable, federal withholding payments, etc. These accounts are meant to only be "in and out accounts," such that at the end of every month, one would anticipate that the balances in these accounts would be \$0. It is the intent that transfers are made only to cover checks that are issued. First Independence Bank is currently performing some type of reconciliation on these accounts and providing it to the System to show that the reconciled balance at the end of every month is \$0. However, the actual cash balances in these accounts are significant (\$20.4 million as of June 30, 2013) and the reconciling items are as well. During the audit, our review of these reconciliations resulted in identifying an overfunding of First Independence Bank accounts, which was not recognized in the general ledger (cash was understated in the general ledger), resulting in a journal entry that was identified by us and posted by the System to ensure the cash was properly reported in the general ledger at year end. We urge the System to perform these reconciliations in a timely manner each month to ensure that the reconciling items are accurate and that cash reported in the general ledger is appropriately recorded. Absent these additional reconciliations, cash could easily be manipulated and fraudulent activity could go undetected for extended periods of time.
- **Employer Contributions** - During this year's audit, several issues surfaced related to the System's tracking of employer contributions. First, the System is not monitoring the employer contributions made by the City of Detroit (the "City") to ensure they are appropriate and in accordance with the actuarial required contribution rates established by the actuary. Second, we noted the System does not perform an annual reconciliation of the employer contribution receivable account. The lack of these controls resulted in an understatement of the original contribution receivable from the City and a failure by the System to consider any collectibility risk related to the contribution receivable, as would be required by GAAP.
- **Journal Entry Review** - A well-run accounting system would ensure that appropriate checks and balances are built into every function. Toward this end, when the System is preparing journal entry adjustments to be made to the System's general ledger, no matter who those journal entries are prepared by, those adjustments should go through a formal approval process. The review process should be more than ministerial; rather, it should be detailed enough to ensure that a second set of eyes are concurring on the adjustments. This will help to minimize reporting errors.

- **Trial Balance Review/Overall Entity-level Monitoring Controls** - Currently, no one reviews the entirety of the trial balances to ensure the various activity posted daily, monthly, or quarterly has been appropriately reflected within the System's general ledger. Such a review would not only encompass a high-level analytical evaluation of the System's various accounts, comparing current year to prior year, but would also ensure that whatever ending balances are recorded can be reconciled to supporting documentation. Without this review, there can be no assurances that the monthly financial activity being reported to the trustees is appropriately reflected of the activity actually occurring at the System.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency in the System's internal control to be a significant deficiency:

- **Controls Over Benefit Calculation** - The System performs retiree benefit calculations for all the retirees that apply for retirement. In order to perform these calculations, the System utilizes various pieces of information such as length of the retiree's service time, annuity factors, date of retirement, etc. During our testing, we did note some inaccuracies in the calculation of certain benefit amounts, generally resulting in overpayments to retirees. The System should have a more effective process in place to ensure that these calculations are accurate and all inputs to arrive at the benefit calculation are appropriate.

Additionally, in cases where the retiree has requested a full withdrawal of their annuity, the System should ensure that all balances are cleared to zero. A review should be performed and any unpaid balances remaining in accounts for such individuals should be paid out.

The lack of a more effective review process over these benefit calculations could result in more significant errors related to the payment of these amounts in the future.

## **Section II - Communications Required Under AU 260**

### **Our Responsibility Under U.S. Generally Accepted Auditing Standards**

As stated in our engagement letter dated September 9, 2013, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of the Police and Fire Retirement System of the City of Detroit (the "System"). Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope previously communicated to you in our meeting about planning matters in September 2013. The timing of the audit was significantly delayed due to timing of receipt of relevant and accurate audit information from the System.

### **Significant Audit Findings**

#### ***Qualitative Aspects of Accounting Practices***

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the System are described in Note I to the financial statements.

As described in Note I, during the current year, the System adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. As a result of adopting this standard, the only impact on the System's financial statements is that the term "net assets" has now been re-labeled as "net position."

We noted no transactions entered into by the System during the year for which there is a lack of authoritative guidance or consensus, other than certain alternative investments for which GAAP provides guidance but not specific rules about valuation.

The City of Detroit, the Plan Sponsor is required by the Michigan Constitution to make the actuarially determined required contribution into the System on an annual basis. As of June 30, 2013, the City owed the System \$71,031,973 in past due contributions. However, because of the uncertainties created by the City's bankruptcy, the System has concluded for financial reporting purposes not to report that revenue until it is received from the City.

There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred other than the recording of approximately \$20,000,000 in adjustments to correct the bank balances at First Independence Bank, which previously were not recognized on the general ledger. This amount was recognized as other income this year.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The valuation of alternative investments constitutes a very sensitive and very significant estimate affecting the financial statements. These alternative investments do not have readily determinable market values. Management uses various means to value the investments, including utilizing a third-party valuation firm, confirmations from the investment managers, periodic appraisals, guidance from real estate advisors, etc. These estimates are very subjective and highly sensitive to change. We believe management's estimates are in accordance with GAAP.

In addition, significant estimates also result from the selection of certain assumptions used in the actuarial valuation, which have an impact on the actuarial accrued liability. The most sensitive estimate used in the valuation was the investment rate of return (discount rate) for which the System is currently using 8 percent. In its November 2012 report, the Public Fund Survey reported that the most common investment return assumption used by public pension plans was 8.0 percent, although there has been a downward trend in that assumption such that the median assumption has changed from 8.0 percent about 10 years ago to 7.8 percent currently.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements is the disclosure of the plan sponsor financial condition.

### ***Difficulties Encountered in Performing the Audit***

We are required to inform those charged with governance of any serious difficulties encountered related to the performance of the audit. Once again this year, we encountered very significant delays in obtaining the information necessary for us to complete the audit. At the time we started the audit in September, we had very little of the information that we asked the System for during the planning discussions in July. Not until late November did we receive a majority of the information (including bank and investment reconciliations) required in order to complete the audit. This resulted in a significant delay related to the timing of issuing the financial statements.

### ***Disagreements with Management***

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### ***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. During the audit, we identified significant adjustments to balances at First Independence Bank, investments, beginning of year net position, credit enhancements, and contributions revenue and receivable. Those adjustments have been fully reflected within the System's year-end financial statements.

The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. This listing includes approximately \$8m of alternative investments selected for testing for which we were not able to obtain sufficient audit evidence.

### ***Significant Findings or Issues***

In the normal course of our professional association with the System, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the System, and business plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition of our retention as the System's auditors.

### ***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated December 19, 2013.

### ***Management Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the System's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### **Section III - Legislative and Informational Items**

#### **Future Accounting Standards**

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 67, *Financial Reporting for Pension Plans - An Amendment of GASB Statement No. 25*. The System will be required to adopt this new accounting standard starting with its fiscal year ending June 30, 2014. The standard makes very significant changes to the manner in which the actuary's report is calculated, at least for financial reporting purposes. The standard prescribes much more limiting conditions on the actuarial calculations as follows:

- Limits the actuarial cost method to just entry age and the amortization method to level percent of payroll, both of which the System is using currently.
- The discount rate used to calculate the present value of projected benefits will not necessarily only reflect the anticipated rate of return on pension investments; rather, it will now incorporate the index rate for high-quality 20-year tax-exempt bonds (AA/Aa or higher) to the extent that the pension system's investments are not projected to fund benefit payments into the future.
- Asset smoothing for purposes of calculating the liability which the City of Detroit will have to record (called the net pension liability) is no longer allowed. For the purpose of calculating the impact to the City's income statement, a five-year smoothing will be allowed.
- The standards used to allow the amortization of the unfunded actuarial accrued liability over a period up to 30 years. Again, for the purpose of calculating the net pension liability, no amortization period will be allowed. However, for the purpose of calculating the impact to the City's income statement, amortization is allowed, but only over the remaining service life of its employees and retirees (generally 8-15 years).
- The actuarial valuation must be measured as of the System's fiscal year end (currently, there is a one-year lag). For the June 30, 2014 year end, the System will need a valuation as of that date or, alternatively, will be allowed to roll forward the results of a valuation performed not more than 24 months before June 30, 2014.

As mentioned, this new standard must be used for financial reporting purposes. However, it is not required to be used for the purpose of calculating the annual required contribution. We encourage you to continue discussions with your actuary as well as the City to ensure efficient coordination with all parties involved.

#### **Michigan's Public Pension Systems - Impact of PA 347 of 2012**

As you are aware, in December 2012, Governor Rick Snyder signed Public Act 347 of 2012 into law. This legislation makes some significant changes that will impact all public retirement systems in Michigan. Amending Public Act 314 of 1965, these new rules are meant to provide greater flexibility to these systems as to how funds are invested, while at the same time imposing additional requirements aimed at transparency and accountability. These changes, which went into effect in March 2013, are summarized below:

### **Changes to Allowable Investment Vehicles**

Generally, rather than making it more restrictive, the new rules raise the maximums for several investment categories, such as real estate and global equities. As an example, the limitations within the “basket clause” are increasing by 10 percentage points, with most plans now allowed to invest between 15 percent and 20 percent within this section, depending upon plan size. Monitoring under these new limitations will continue to be important. Toward this end, plans will need to ensure their investment consultants, advisors, and managers are "on board" with the changes.

### **Spending Limitations**

This act would limit the amount of spending on professional training, education, and travel. Under the legislation, the retirement system's board of trustees would be required to adopt an annual budget for professional training and education, including travel. This budget will be capped at the lesser of \$150,000 or an amount equal to \$12,000 multiplied by the number of board members, with professional training, education, and travel costs not to exceed \$30,000 for any one board member.

### **Additional Documentation and Reporting Requirements**

Additional transparency reporting requirements for retirement systems, investment fiduciaries, and investment service providers are being imposed by this new public act. First, the legislation would require the publication by the plan of a Summary Annual Report (SAR). Although similar reporting requirements exist in the old legislation, this act requires more detailed reporting than what we are used to.

The SAR would include several additional disclosures, including the following: names of investment service providers, the system's itemized budget (including professional training, education, and travel), disclosure of the system's investment returns, and numerous pieces of information from the system's most recent annual actuarial valuation report. The system is required to make its SAR available to plan participants and citizens via posting to its website if the system has a website or, alternatively, would require the plan sponsor to post it to their website.

In addition, investment service providers are now required to give the investment fiduciary a complete written disclosure of all fees or other compensation associated with its relationship with the retirement system. This disclosure would be required both before providing any investment services as well as on an annual ongoing basis. Finally, financial records of the system must be retained for a minimum six-year period.

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

December 19, 2013

Client: **Police and Fire Retirement System of the City of Detroit**  
Y/E: **6/30/2013**

**SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS**

The pretax effect of misstatements and classification errors identified would be to increase (decrease) the reported amounts in the financial statement categories identified below:

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Equity	Revenue	Expenses	Pretax Income
<b>FACTUAL MISSTATEMENTS:</b>									
A1	Record receivable related to lawsuit settlement that was settled in favor of System		\$ 2,125,000				\$ 2,125,000		\$ 2,125,000
	To adjust the fair market value of the MuniMae construction loan	\$ 2,300,000					2,300,000		2,300,000
<b>JUDGMENTAL ADJUSTMENTS:</b>									
B1									
B2									
<b>ITEMS UNABLE TO AUDIT:</b>									
C1	Alternative investments that PM was not able to audit	(7,818,000)					(7,818,000)		(7,818,000)
C2									
	Combined effect	<u>\$ (5,518,000)</u>	<u>\$ 2,125,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (3,393,000)</u>	<u>\$ -</u>	<u>\$ (3,393,000)</u>
<b>PASSED DISCLOSURES AND OTHERS:</b>									
D1	The impact of the change in the provision which previously allowed employees to roll 25% of unused sick and vacation into their AFC was not taken into consideration within the 2012 actuarial valuation.								
D2									